

BUSINESS LAW SECTION

CORPORATIONS COMMITTEE

COMMITTEE MEETING MINUTES FOR May 17, 2002

Friday, May 17, 2002
Carlsbad

A regular meeting of the Corporations Committee (the "Committee") of the Business Law Section of the State Bar of California was held at the La Costa Resort and Spa in Carlsbad. Attendance was as follows:

MEMBERS PRESENT:

Keith Paul Bishop
David S. Caplan
John C. Carpenter
Bruce Dravis
Timothy J. Fitzpatrick
James F. Fotenos
Steven K. Hazen
Mark T. Hiraide

Carol K. Lucas
Brian D. McAllister
B. Keith Martin
David M. Pike
Cynthia Ribas
Randall B. Schai
James R. Walther
Neil J Wertlieb

MEMBERS ABSENT:

Nelson D. Crandall
James K. Dyer, Jr
Teri Shugart Erickson
Eileen Lyon
Ethna M. Piazza
Daniel Weiser Nancy Wojtas

LIAISONS PRESENT:

Hugh A. O'Boyle, Corporate Law Department Committee
Robert F. Stansell, Executive Committee
Todd Vlaanderen, Secretary of State

GUESTS PRESENT:

Terry Miller, Legislative Office of the State Bar
Charles Rumbaugh, Franchise Committee
Ann Y. Walker, Co-Chair of State Bar Sections

The minutes summarize discussions primarily in the order items were listed on the Agenda for the meeting previously circulated to members of the Committee, which is not necessarily the order in which the items were actually taken up at the meeting. The Committee did not take up those topics listed on the Agenda, which are not described in these Minutes.

I. ADMINISTRATIVE MATTERS.

A. Opening Remarks and Announcements. The meeting was brought to order by Co-Chair Neil Wertlieb at approximately 9:00 a.m. Mr. Wertlieb asked members and guests to introduce themselves. Mr. Wertlieb then noted that the next meeting of the Committee was scheduled for June 7th in San Francisco and asked whether members would like to cancel that meeting and, instead, hold the next meeting of the Committee in July. Members agreed that the next meeting should be held on July 12th.

B. Approval of Minutes of April 5, 2002 Meeting. The draft minutes of the meeting of the Committee held on April 5, 2002 and previously circulated to the members of the Committee were approved without comment.

II. LIAISONS' REPORTS AND DISCUSSION.

A. Department of Corporations. A liaison from the Department of Corporations was not present at the meeting, however, Keith Bishop noted that the Department had not issued any new rule proposals recently. He also informed the Committee that the Department has a new help phone number (1-866- ASK-CORP) which the general public can call with questions about routine matters affecting corporations.

B. BLS Executive Committee. Robert Stansell reported that new officers were elected at the last meeting of the Executive Committee and that Tim Hoxie will now be the Chair of the Executive Committee. Mr. Stansell commented that the Executive Committee is placing an emphasis on encouraging new applicants to the various standing committees of the Business Law Section and asked that members of the Committee recommend people to serve on the various committees. Applications are available on the California State Bar website (<http://www.calbar.org>).

C. Secretary of State. Todd Vlaanderen provided an update on the activities of the Secretary of State. He noted that there have been a few updates to the filing tips section of the Secretary of State's web site. The members of the Committee discussed the procedure for reviving the status of a corporation. Mr. Vlaanderen commented that revivor of a corporation is now done only through the Secretary of State's office (previously, this had been done through the Franchise Tax Board).

D. Corporate Law Departments Committee. Hugh O'Boyle reported on the activities of the Corporate Law Departments Committee. He noted that the committee is holding a meeting today. He also reported that the committee is working on articles for the Business Law News concerning (i) in-house attorneys and multijurisdictional practice and (ii) issues concerning legal opinions delivered by in-house counsel. Mr. O'Boyle also noted that the committee is focusing on a membership drive to increase participation in the committee. The committee is also presenting two programs at the Spring Meeting of the Business Law Section and will have a program on doing business in China at the annual meeting of the State Bar in October.

E. Partnerships and Limited Liability Companies Committee. Steven Hazen provided an update on the activities of the Partnerships and LLC Committee. The committee met last month and is also meeting today. Mr. Hazen noted that the committee has been focusing its efforts in the last sixty days on completing comments regarding the Revised Uniform Limited Partnership Act. Mr. Hazen also reported that the Guide to Limited Liability Companies prepared by the committee should be completed shortly and that he will distribute copies of the Guide electronically to members of the Corporations Committee, when available. Mr. Hazen also said that the committee has been considering SB399 (corporate conversions) and its impact on any residual obligations of a former partner of a partnership as well as the Section 25102(o) regulations regarding the exemption for stock option plans and its relationship to federal Rule 701. He also noted that AB601 (which expands existing law regarding covenants not to compete to include any business entity) is on the agenda for discussion this month. Mr. Hazen noted that the staff of the Senate Judiciary Committee had comments regarding AB601 and the Partnership's Committee will be discussing how to respond. Terry Miller commented that Gloria Ochoa, consultant to the Judiciary Committee, had made some revisions to AB601, which were acceptable to the Partnerships Committee and the Executive Committee of the Business Law Section. However, Gene Wong, staff attorney for the Judiciary Committee, has raised some new concerns with the bill. Mr. Miller noted that a conference call is scheduled for June 5th with Ms. Ochoa, Mr. Wong and members of the Partnerships Committee to discuss and resolve open issues. The bill is scheduled for a hearing with the Senate Judiciary Committee on June 18th. Mr. Wertlieb requested that members of the Committee experienced in working with noncompete provisions contact him to participate in the conference call or to meet with staff members of the Senate Judiciary Committee in Sacramento. Finally, Mr. Hazen noted that he is also participating in an ad hoc group of attorneys and accountants monitoring recent and proposed activities of the Financial Accounting Standards Board ("FASB") arising out of the Enron situation and which could have a significant impact on the use of limited liability companies as special purpose entities in financing transactions such as synthetic leasing. Mr. Hazen noted that FASB is realizing that there are both advantages and disadvantages to special purpose entities and that there are ways to abuse the process that

should be fixed, rather than simply doing away with special purpose entities altogether. He also reported that FASB has scheduled the release of an exposure draft relating to special purpose entities at the end of this month, but it is unclear what the status of the draft is at this point.

F. Health Law Committee. Carol Lucas reported that the Health Law Committee held a meeting last week and has scheduled a presentation on health care law for non-health care attorneys for tomorrow (May 18th) at the Spring Meeting of the Business Law Section. Ms. Lucas also reported that the Health Law Committee is sponsoring legislation to add dentists to the list of professionals permitted to organize as a professional corporation under Section 13401.50. This proposal has been approved by the Executive Committee and is being sponsored by Assemblywoman Cohn in the legislature.

III. PENDING LEGISLATION/AFFIRMATIVE LEGISLATIVE PROPOSALS.

A. Report of Legislative Liaison. Mr. Fotenos summarized the following legislation of interest to the Committee:

- **AB601 (Leach)**

Existing law authorizes a person who sells the goodwill of a business and a shareholder disposing of all of his or her shares in the corporation or all or substantially all of the assets of the corporation together with the goodwill of the corporation, to contract with the buyer to refrain from competing with the business so sold, under certain conditions. This bill would extend this authorization to any owner's sale or other disposition of the ownership interest or assets, together with the goodwill, of a business entity or a division or subsidiary thereof.

- **AB1875 (Nakano and Correa)**

Existing law sets forth procedures for the creation and dissolution of a corporation. This bill would authorize the filing of articles of dissolution with the Secretary of State relative to the dissolution of a corporation that has not issued shares and would revise certain related provisions.

- **AB1995 (Correa)**

Existing law establishes the California Board of Accountancy in the Department of Consumer Affairs for the purpose of licensing and regulating public accountants. This bill would provide that a licensee would not be considered independent for purposes of certifying financial statements of a publicly traded audit client if the licensee's firm performs services for the client or an affiliate of the client other than certain authorized services.

- **AB2187 (Lowenthal)**

Existing law provides that it is unlawful for a person to offer or sell in this state any security in an issuer transaction unless the sale has been qualified or the security or transaction is exempted or not subject to qualification. This bill would create an exemption where an offer or sale of a security issued by a corporation or limited liability company pursuant to a purchase plan or agreement, or issued pursuant to an option plan or agreement, at the time of issuance or grant would have been exempt from registration except for the fact that the issuer is subject to specified reporting requirements of the Securities Exchange Act of 1934.

- **AB2355 (Campbell)**

Limited liability companies are regulated pursuant to the Beverly-Killea Limited Liability Company Act. This bill would extend these provisions to an application by a judgment creditor against an assignee of the membership interest, and would provide that service of a notice of motion for charging order on a judgment debtor and on the other members or the limited liability company creates a lien on the judgment debtor's assignable membership interest in the limited liability company.

- **AB2873 (Frammer and Correa)**

Existing law establishes the California Board of Accountancy, in the Department of Consumer Affairs, for the purpose of licensing and regulating public accountants. This bill would require audit working papers to contain sufficient documentation to enable a reviewer with relevant knowledge and experience, but having no previous connection with an auditing engagement, to understand the nature, timing, extent, and results of auditing or other procedures performed, evidence obtained, conclusions reached, and the identity of the persons who performed and reviewed the work.

- **AB2969 (Florez)**

Existing law provides exemptions from state usury provisions for loans that meet certain requirements, with specified financial statements as necessary evidence. The financial statements are required to meet specified requirements, including being prepared (i) in accordance with generally accepted accounting principles and, if the entity has consolidated subsidiaries, on a consolidated basis, and (ii) in accordance with the rules and requirements of the Securities Exchange Commission. This bill would instead require the financial statements to meet one of the above requirements, rather than both of those requirements.

- **SB399 (Ackerman)**

Existing law provides for the creation of various forms of business organizations, including various forms of partnerships, corporations, and limited liability companies, and provides for conversion of certain of these forms of business organizations, other than corporations, into other forms of business organizations. This bill would establish procedures for the conversion of California corporations into domestic limited liability companies, limited partnerships, or general partnerships.

- **SB1472 (Romero)**

Existing law sets forth various requirements applicable to a corporation with outstanding shares of record held by 100 or more persons relative to a supermajority vote requirement for an amendment of the articles of incorporation or a certificate of determination. This bill would delete one of these conditions and make other related changes.

- **SB1473 (Machado)**

Existing law requires any person who engages in business as a broker-dealer to be licensed and regulated by the Commissioner of Corporations. Existing law authorizes the commissioner to bring a civil action against a person who is in violation of a law or order regulating broker-dealers. This bill would specify that in a case brought by the commissioner where a defendant is ordered to pay restitution, the order is deemed a money judgment and is fully enforceable by the victim as if it were a separate civil judgment.

- **SB1814 (Dunn)**

Existing law, the Cartwright Act, makes every trust, subject to specified exemptions, unlawful, against public policy, and void. This bill would specify that liability under the Cartwright Act is not precluded because the trust combination is between 2 or more persons who are related to one another by common ownership.

B. SB399 (corporate conversions). Mr. Wertlieb reported that the bill had been held in the Senate Judiciary Committee due to discussions concerning the issue of requiring a converting partnership to notify creditors of that partnership prior to conversion of the partnership into a corporation. Previously, the Corporations Committee had voted in favor of the notice requirement and supported the revised bill. Mr. Wertlieb reported that he had spoken with the Insolvency

Committee who were requesting both a notice requirement and some continuing liability for general partners of a partnership. The Insolvency Committee concluded that it would neither support or oppose the revised bill. The Executive Committee also reviewed the revised bill and decided that it would support the revised bill if at least two of the three relevant committees (Corporations Committee, Insolvency Committee and Partnerships Committee) agreed on an approach to the suggested revisions. Terry Miller, from the Legislative Office of the State Bar, noted that June 24th is the last day to hear the bill and report to the Assembly floor so the Executive Committee must make a decision soon. Mr. Miller also noted that the bill, as now written, has a relatively good chance of passing. Mr. Hazen reported to the Committee that he participated in a portion of the meeting of the Partnership Committee, being held concurrently with the meeting of this Committee, and that the Partnership Committee had approved changes to the last sentence of paragraph (f) in the proposal to state that failure to comply with subdivision (f) shall not affect the validity of a conversion or extend the ninety day period in subparagraph (e). The Committee unanimously approved the changes suggested by the Partnership Committee. Mr. Stansell noted that the Executive Committee should approve the suggested language changes if the Insolvency Committee does not object to the changes. Mr. Caplan volunteered to work with the Insolvency Committee if that committee raised objections to the new language. Mr. Miller said that he would meet with the staff of the Senate Judiciary Committee to discuss the changed language after it has been approved by the Executive Committee. The Committee also unanimously approved a resolution authorizing Messrs. Bishop, Fitzpatrick and Wertlieb to act as a subcommittee to work with the language of the bill prior to the next meeting of the Committee.

C. Section 25102(o) Regulation Comments. Mr. Bishop reported that the Los Angeles County Bar Association had submitted its own proposal to amend Section 25102(o) to expand the exemption to include '34 Act reporting companies that do not currently qualify for the exemption under Section 25102(o). He noted that the Department of Corporations opposed this proposal and it was subsequently terminated. Mr. Bishop further noted that he submitted his own comments on the proposed 25102(o) regulations as did several other people, but he has not yet spoken to the Department of Corporations to see how they will proceed.

D. Section 710 (sunset on supermajority approvals). Bruce Dravis reported that SB1472 was approved by the Senate Banking Committee and the Senate Judiciary Committee and will now be submitted to the full Senate for approval.

E. Technical Corrections Bill. Mr. Wertlieb reported that he received an email from Jim Dyer stating that AB2969, which makes technical corrections to Corporations Code Sections 25118(a) and 25120 had passed the Assembly and would now be submitted to the Senate for consideration. Mr. Dyer noted in his email that one suggested change to Section 25120 was not necessary, since it had been corrected in legislation passed last year. Mr. Fitzpatrick said that he would review this particular language in the bill and report back to the Committee.

IV. POTENTIAL AFFIRMATIVE LEGISLATIVE PROPOSALS.

A. Secretary of State Fax Filings. Mr. Dravis said that he had a number of email exchanges with Pamela Giarrizzo at the Secretary of State's office concerning the draft fax filings proposal reviewed by this Committee. Ms. Giarrizzo requested that any references to photocopied signatures be removed from the draft proposal and that the language in the proposal should be limited to facsimile signatures on documents delivered over the counter for filing with the Secretary of State. Ms. Giarrizzo further emphasized that the Secretary of State's Office will not directly receive faxed documents for filing. Mr. Dravis further reported that he will prepare a draft legislative proposal and will circulate the draft to Members for comments and formal vote by email prior to submitting to the Executive Committee. The Committee authorized Messrs. Dravis, Fitzpatrick and Walther to act as a subcommittee to review the draft legislative bill when it is completed.

B. 25118(b) Definition of Aggregate Evidence of Indebtedness. Mr. Wertlieb reported that he spoke with Dan Weiser about this issue. Mr. Wertlieb asked members of the Committee to review

the memo Mr. Weiser previously circulated to members of the Committee and suggested that this issue be deferred until next month's meeting, when Mr. Weiser should be available discuss the issue with the members.

C. Amend Corporations Code to Permit Electronic Communications to Constitute a

"Writing." Mr. Schai reported that the working group for this issue met by telephone last month and that the text of the group's proposal had not changed significantly since it was circulated to the members of the Committee several months ago. Mr. Schai also reported that the working group is writing a commentary to the legislative proposal which will be circulated to the members of the Committee prior to the July meeting of the Committee.

D. Amend Finance Lenders Law. Mr. Bishop reported that the Department of Corporations adopted Section 260.204.9 last year, exempting general partners of venture capital firms from registering as investment advisers. The next step should be to exempt venture capital firms from the finance lenders licensing requirements in California. Mr. Bishop reported that the proposal he drafted would create an exemption for venture capital firms, as defined in Section 260.204.9, and that the proposal reflects initial comments from the Department of Corporations. Members of the Committee unanimously approved a resolution authorizing Messrs. Bishop and Fotenos to act as a subcommittee to finalize the language of the legislative proposal and submit the proposal to the Executive Committee for approval. Mr. Bishop noted that this proposal, if approved by the Executive Committee, would be sent to the legislature in January 2003.

V. WEB SITE PROJECTS.

A. Website Update. Mr. Caplan requested that members of the Committee responsible for various Committee projects review the Committee website to see if the descriptions of projects are accurate. Mr. Caplan also noted that Mr. McAllister will assume responsibility for updating the Committee website.

VI. OTHER PROJECTS.

A. Educational Activities. Mr. Dravis reported that Ms. Ribas and Roy Schmidt will be chairing a presentation on comparison of California and Delaware corporate law today in connection with the Spring Meeting of the Business Law Section. Mr. Dravis noted that the presentation materials for this seminar may form the basis of an article for The Business Law News.

B. Opinion Project. Ms. Lucas reported that the opinion committee of the Business Law Section is spending considerable time analyzing California and New York approaches to enforceability provisions. The committee is reviewing forms of enforceability opinions delivered by New York and California law firms and Ms. Lucas asked that members of the Committee from firms with California and New York offices send her samples of remedies opinions delivered by those firms.

C. 25102(f) Regulations/Legislative Proposal. Mr. Fitzpatrick led a discussion concerning the legislative proposal regarding a "reasonable belief" standard for Section 25102(f).

VII. New Business.

A. Recruiting New Members. Mr. Wertlieb noted that it is critically important that this Committee continue to recruit new members. He suggested that a recruiting subcommittee be established to monitor recruiting efforts of the Committee. Messrs. Dravis, Fotenos, Hiraide, Schai and Wertlieb volunteered to serve on this subcommittee.

B. ADR Committee. Mr. Wertlieb introduced Jerry Phillips, the Chair-Elect of the ADR Committee of the State Bar and a member of the ad hoc ADR Committee of the Business Law Section. Mr. Phillips made a brief presentation to the Committee focusing on coordination of the work being done by the various ad hoc ADR committees and his desire that the ADR Committee of the State Bar have its members participate in the various ad hoc committees of the Sections.

C. Practice Issues. Mr. Schai made a presentation concerning his recent experience with a "PIPE" transaction for preferred stock. The transaction included a deemed liquidation preference and a partial cash pay-out. The company's auditors had revisited the accounting treatment for PIPE investments in light of the Enron situation and concluded that if any liquidation events are not at the discretion of the Board, then the preferred stock would be classified as debt. Mr. Wertlieb stated that he would include relevant material concerning this transaction in the materials for the July meeting of the Committee.

The meeting was adjourned at approximately 12:00 p.m.

/s/ David M. Pike
David M. Pike
Secretary

Corporation Committee Meeting Minutes

